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# **Industrial Policies of North America and Their Implications for U.S. Trade and Investment Relations**

by J. David Morrissy\*

A North American trade accord between Canada, Mexico, and the United States evokes little enthusiasm today despite years of expanding trade and investment. Worldwide recession, high unemployment levels, economic disruption due to shifting oil prices, overextended indebtedness, and recent devaluations of Canadian and Mexican currencies sharply discount the projected benefits from closer economic interdependence. More deep-rooted and intractable than these economic phenomena are the divergent industrial policies that inhibit further North American market coalescence. For Mexico, trade is an "instrument for development."<sup>1</sup> For Canada, "Canadianization" of industry means a specific industrial strategy to which foreign trade and investment are subordinated. For the most part, U.S. policy toward industry is neutral and is based on the general principle of freedom of the domestic marketplace and liberalized access to it for all producers, domestic and foreign. The North American asymmetrical trade and industrial policies tend to cause distortions in the pattern of trade and investment flows and pose significant hurdles in the way of negotiations for a North American trade agreement, even if it were eagerly desired.

This article provides a comprehensive review of the complex interaction of the industrial and trade policies of Canada and Mexico, and the impact such policies are having on their trade relations with the United States. Part I outlines the potential conflict between national industrial development programs and the need for a liberalized North American trade system. Parts II and III examine the trade policies and industrial development plans of Mexico and Canada, respectively, and Part IV considers various North American trade arrangements currently in operation. Finally, Part V emphasizes the need to examine North

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\* Senior International Economist, Office of the U.S. Trade Representative. The views expressed in this article are those of the author and are not intended to represent official views or policies of the U.S. Government.

<sup>1</sup> GSP, Countervailing Duty Concerns Highlight FBA's Mexican Trade Session, 7 U.S. Import Weekly (BNA) No. 1, at 7 (October 6, 1982) [hereinafter cited as Countervailing Duty Concerns] cites Alfredo Gutierrez Kirchner, Minister-Counselor of Trade, Mexican Embassy, Washington, D.C.

American trade relations with a view to developing a shared perspective and a common framework within which the United States, Canada, and Mexico can work toward greater harmonization of their trade policies and practices. U.S. trade relations have not been static, and many of the issues discussed in this paper have been, and continue to be, subject to significant changes in policy.

## I. North American Trade and Investment

Trade and investment flows have increased the degree of interdependence among Canada, Mexico, and the United States. In 1981, U.S. trade with Canada<sup>2</sup> and Mexico<sup>3</sup> amounted to \$87 billion and \$32 billion, respectively. Trade with the United States accounts for two-thirds of the total trade flows of Canada<sup>4</sup> and Mexico.<sup>5</sup> While only one-fourth of total U.S. trade was with these countries, Canada and Mexico were the first and third largest U.S. trading partners in 1981.<sup>6</sup>

Likewise, sizeable investment flows doubled in the 1970's. In 1979 alone, U.S. direct investment in Canada amounted to \$41 billion<sup>7</sup> and in Mexico, \$4.5 billion.<sup>8</sup> In the same period, Canada's direct investment in the United States amounted to \$7 billion.<sup>9</sup>

The underlying impetus for continuing expansion of North American trade and investment remains the enormous complementary assets with which the North American continent and adjacent countries are endowed: mineral resources, vast, fertile farmlands, and varying population growth levels. In addition to enormous reserves of oil, gas, and hydroelectric power sources, the North American region possesses from one-fifth to one-third of each of the world's basic ferrous and nonferrous metal ore deposits.<sup>10</sup> North American farmland yields one-fifth of the total world grain supply.<sup>11</sup>

The expansion and rising affluence of the Canadian, Mexican, and U.S. population, currently at 319 million,<sup>12</sup> will likely cause subtle changes in North American trade flows. An uneven growth in population already is changing profoundly the relative size of national markets.

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<sup>2</sup> U.S. Dep't of Comm., 63 Survey of Current Bus. No. 3, S-19 to S-20 (March 1982).

<sup>3</sup> Id.

<sup>4</sup> U.S. Int'l Trade Commission, Pub. No. 1176, Background Study of the Economic and International Trade Patterns of the Countries of North America, Central America, and the Caribbean 136 (1981) [hereinafter cited as Background Study].

<sup>5</sup> Id.

<sup>6</sup> Id. at 127.

<sup>7</sup> Id. at 30.

<sup>8</sup> Id.

<sup>9</sup> Id. at 34.

<sup>10</sup> Office of the U.S. Trade Representative, North American Trade Agreements, A Study Mandated in Section 1104 of the Trade Agreements Act of 1979, 4 (1981) [hereinafter cited as Trade Agreements].

<sup>11</sup> Id. at 3.

<sup>12</sup> Current and projected regional populations for North America, in millions, are as follows:

By the year 2000, the region's population will exceed 390 million.<sup>13</sup> Nearly sixty percent of that growth will occur in Mexico.<sup>14</sup>

#### *A. Industrial Development*

To prepare for population expansion, many North American countries are turning to industrial development policies to stimulate job creation and raise income levels. For some countries the domestic situation is already critical. Unofficial estimates place Mexico's unemployment rate today at twenty percent, and its combined unemployment and underemployment rate was forty-nine percent in 1979 according to official Mexican estimates.<sup>15</sup> On the other hand, relatively underpopulated Canada has turned to industrial development policies to prevent the erosion of its industrial base. However, Canada's efforts to build its industry behind higher tariff walls means that firms serve smaller markets with shorter production runs and higher production costs than those in the United States.

Both Canada and Mexico are attracted by the job generating prospects of supplying the enormous U.S. market. At the same time, they are apprehensive that closer trade ties might draw reverse flows of U.S. trade and investment into their own domestic markets and preempt the development of their national industries. Therefore, both countries have tried to diminish the relative intensity of their trading relationships with the United States.

Logically, there are two means by which Canada and Mexico can diminish the intensity of their U.S. trade. One is to solicit increased trade and investment with the Western European countries and Japan. The other is to spur industrial development through domestic enterprises and admit U.S. trade and investment only where the advantages outweigh the disadvantages of increased U.S. presence in the economy. Canada and Mexico both have taken each of these approaches. They are the two basic elements of the strategy that in the 1970s Canadians referred to as their "third option."

The first option was to hold relations with the United States to the status quo. The second was to seek a "special relationship" by way of closer integration between Canada and the United States. Although the third option, the stimulation of both European and Japanese trade and domestic industrial development, may not be considered an overwhelm-

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	1980	Projected 2000
United States	225	252
Canada	24	28
Mexico	70	116
	319	396

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Background Study, *supra* note 4, at 6.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 26.

ingly successful experiment, its motivating force derived as much from cultural and political affirmations of sovereignty as from economic calculations. That Canadian spirit of independence no longer favors a "special relationship" between Canada and the United States. Mexico has always been wary of any special relationship with the United States. Consequently, both Canada and Mexico have sought to diminish their economic involvement with the United States and to develop a broad competitive industrial base. To that end they have adopted policy directives to guide and encourage industrialization, particularly in selected sectors, to maintain control over energy resources, to foster native ownership of industry by controlling access to investment, to enhance foreign investment effectiveness by setting performance requirements, and, in all these, to improve their trade balance with the United States. Yet the two countries pursue these goals by different mechanisms with little similarity in the ways their methods relate both to the United States and to each other.

### *B. Liberalized Trading System*

No one can challenge the right and responsibility of a country to protect its political and economic sovereignty. However, when industrial and trade policies adopted to foster economic development conflict with the trading rights of trade partners, the results can be disastrous. Relations between the countries may deteriorate seriously if there are no mechanisms for resolving trade disputes. On the other hand, if the policies go unchallenged, other countries might adopt similar policies which could cause an erosion of the benefits of a free trading system and possibly precipitate a wave of protectionism. Developing countries might then adopt reciprocity measures to curtail imports from countries that appear to exploit the system.

The countries of North America not only need a mechanism by which to resolve the trade disputes that invariably arise, but also need a shared understanding that continued liberalization of North American trade is beneficial to all participants. Unfortunately, when the North American countries decided that special relationships with the United States did not serve their interests, they did not develop a new, integrating vision for North American trade relations. As a result, considerable tension now attends the resolution of bilateral trade disputes.

Multilateral mechanisms, such as the General Agreement on Tariffs and Trade (GATT),<sup>16</sup> are helpful, but they generally lack a framework with a regional perspective and shared objectives. The GATT provides

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<sup>16</sup> General Agreement on Tariffs and Trade, *opened for signature* October 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700 [hereinafter cited as GATT]. GATT is not a single treaty. It resulted from a United Nations conference on Trade and Employment, and its text was attached to the final Act of the Conference. The U.S. accepted GATT in Protocol for the accession of signatories of the Final Act of October 30, 1947, 62 Stat. 3663, T.I.A.S. No. 1887, 62 U.N.T.S. 68. Numerous protocols have amended GATT. See, e.g., Protocol amending the general agreement

rules and procedures for resolving trade disagreements among its eighty-seven members. Both Canada and the United States are signatories, and both on occasion have resorted to GATT dispute resolution mechanisms when informal bilateral efforts were not effective.<sup>17</sup> The current degree of trade liberalization that exists in world markets is derived from tariff and nontariff concessions worked out in past GATT negotiating sessions. Such concessions are binding in justice because other signatory nations made compensatory concessions; therefore, they cannot be unilaterally rescinded.

## II. Mexican Trade Policies

With Mexico, the United States has neither a shared vision of their trade relations nor a trade agreement mechanism. Except for a bilateral reciprocal trade treaty entered into during World War II, which Mexico allowed to expire in 1950,<sup>18</sup> there has been no formal trade agreement between the two countries. Mexico participated actively in the Tokyo Round of the GATT Multilateral Trade Negotiations (MTN) and was preparing to make trade concessions to the United States in return for U.S. trade concessions. However, in March 1980, after domestic discussion revealed a widespread apprehension that compliance with the newly negotiated codes, especially the subsidies code, might prevent the use of incentives designed to foster its industrial development policies, Mexico reversed its apparent earlier willingness to join the GATT and announced its decision not to become a signatory nor to adhere to the MTN nontariff codes.<sup>19</sup>

Since Mexico has rejected the multilateral approach to trade agreements, the prospects for a trade agreement with Mexico on a bilateral, trilateral, or regional basis are moot. The principal difficulty that the United States faces is that as a signatory to the GATT any agreement it makes bilaterally must be consistent with its fundamental obligations under the GATT rules.<sup>20</sup> Accordingly, it would be difficult for the United States to devise trade advantages it could concede to Mexico that it would not make to all GATT signatories. Even if the United States could put together bilateral concessions that are attractive to Mexico, it

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to introduce a part IV on trade and development and to amend Annex I, Feb. 8, 1965, 17 U.S.T. 1977, T.I.A.S. No. 6193.

<sup>17</sup> For example, negotiations under GATT Article XXVIII began in 1978 at the initiative of the United States due to Canadian revision of duties on fruits and vegetables. See Twenty-Fourth Annual Report of the President of the United States on the Trade Agreements Program 83 (1979) [hereinafter cited as *Trade Agreements Report*].

<sup>18</sup> Ventana Associates, Inc., *Mexican Industrial Development Plans: Implications for United States Policy* 237 (1981) (prepared for the U.S. Departments of State and Commerce and the Office of the U.S. Trade Representative) [hereinafter cited as *M.I.D.P.*].

<sup>19</sup> *Id.* at 40-41.

<sup>20</sup> According to Article I of the General Agreement on Tariff and Trade, signatories must grant to other signatories what is granted to its "most favored nation" for the item in question. See, GATT, *supra* note 16, at 61 Stat. A3, A12.

might be unwise as a matter of policy to offer better terms outside the GATT framework than Mexico could get within it. The reason which President José López Portillo gave in his 1980 State of the Union message for not joining the GATT would seem to apply to all trade treaties with equivalent obligations: "We must not allow that which is woven in one part of our development to be unwoven in another."<sup>21</sup>

What are the development policies that must not come undone through enactment of trade agreements? The major policy areas that might obstruct negotiation of a trade agreement relate to industry, energy, and agriculture. Mexico's development policies have been shaped in an environment of international independence and relative isolation. Mexico has remained detached from global commitments, and until the recent discovery of the country's oil resources, the world largely ignored it. When Mexico nationalized its oil industry in 1938, it made clear that it had reasserted control over its development without regard to foreign interests. Now that it is one of the major world producers of petroleum, it still remains outside the Organization of Petroleum Exporting Countries (OPEC). Mexico looks upon its oil as its special patrimony, a resource to be drawn upon frugally and developed without regard to world demand.<sup>22</sup> However, this stance is softening under the pressure of Mexico's current economic problems.

Mexico has allowed its role as a world leader to evolve in one area, namely its function as a spokesman for developing countries. Mexico still regards itself as a developing country, although it is now emerging as an industrialized nation. Its industrial growth, most of which occurred prior to its recent oil discoveries, was accomplished through determined development efforts. How it will handle its trade responsibilities to other nations as it graduates from a newly industrializing country to a developed country remains to be seen. The current crisis will make this transformation significantly more difficult.

The continuity of the development policies affecting Mexico's trade relations is of legitimate concern as Miguel de la Madrid Hurtado succeeds López Portillo. Since López Portillo selected de la Madrid,<sup>23</sup> a basic compatibility of viewpoint is anticipated, and de la Madrid's background reinforces that expectation. Like López Portillo's, de la Madrid's career has been in public administration, his education in law and public administration, and his technical experience in finance and programming.<sup>24</sup>

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<sup>21</sup> State of the Union Address by President Portillo (Sept. 1980), reprinted in M.I.D.P., *supra* note 18, at 42.

<sup>22</sup> M.I.D.P., *supra* note 18, at 67-68.

<sup>23</sup> *Id.* at 44-45.

<sup>24</sup> *Id.*

### A. *The Global Plan*<sup>25</sup>

As Minister of Planning and Budget, de la Madrid was the architect of López Portillo's Global Plan. When de la Madrid introduced the plan in 1980 he cautioned that "the Plan is not a map finished to precision that will carry us mechanically to the objectives."<sup>26</sup> Nonetheless, the plan is probably a reliable indicator of Mexico's future domestic policies just as it is built on the antecedent development plans that de la Madrid participated in developing, such as the National Industrial Development Plan (NIDP).<sup>27</sup>

The current crisis undoubtedly will prompt Mexico to make major modifications in the NIDP, which has various incentives designed to promote expansion in targeted industries. Primary emphasis was given to food processing. The next development priority concerned the capital goods sector, especially food processing equipment manufacturers, and machine and tool suppliers to basic industries, especially petrochemicals, electrical generation, mining and metallurgy, construction, and transport vehicles and equipment.<sup>28</sup>

Where the NIDP assigns priorities to investment in certain industries and regions, it rewards investors that comply by means of a complex set of incentives. The NIDP incentives take various forms. A credit, or CEPROFI, can be earned against taxes in amounts of up to thirty percent of the fixed value of assets when investments are made in specified regions or industries.<sup>29</sup> A small firm, for example, by investing in a food processing plant using domestically produced capital goods in a region designated for preferential development, could earn the maximum tax credit. By initiating additional work shifts, thereby creating more jobs and increasing productivity, it could earn a twenty percent tax credit within the thirty percent ceiling. (See Appendix, page 449).

The NIDP also established a tax credit system whereby a credit, or CEDI, was granted against indirect and value-added taxes in proportion to both the domestic content and the value added.<sup>30</sup> A firm with high proportions of both could secure credits of up to eighty percent of its tax liabilities. Additional credits were issued for firms that raised their export levels from year to year. In 1981, these incentive systems were linked, making them available during the tax year once a stipulated portion of a firm's output has been exported.<sup>31</sup> In August 1982, José Gutierrez Kirchner reported that this major program was suspended when the rest of eligible articles were eliminated. The CEDI was no longer needed

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<sup>25</sup> *Id.* at 15.

<sup>26</sup> *Id.*

<sup>27</sup> See generally *id.* at 60.

<sup>28</sup> *Id.* at 20-22.

<sup>29</sup> *Id.* at 22-24.

<sup>30</sup> *Id.* at 26-27.

<sup>31</sup> *Id.* at 27-28.



because the peso was no longer overvalued.<sup>32</sup> While recent major devaluations make Mexican products competitive in export markets, production bottlenecks may limit the volume of products that can be made available for export.

Incentives also take the form of low-cost energy supplies. For example, firms locating in the preferred zones or along the natural gas pipeline benefit from purchases of gas at thirty-two cents per thousand cubic feet (cfm), while it is currently sold at the border to U.S. producers at \$4.94 per cfm.<sup>33</sup> Petrochemical firms locating in preferred zones can get additional discounts of up to thirty percent on gas, as well as oil and electricity, provided they export twenty-five percent of their output.<sup>34</sup>

At a time when U.S. deregulation policies are permitting gas and oil to rise to world price levels, low-cost energy incentives give Mexican firms in fuel-consuming industries a competitive advantage. International firms competing in Mexican export markets may charge that Mexico's low-priced fuels constitute an import subsidy for manufacturers in the same way that U.S. firms using regulated natural gas have been challenged. Furthermore, because Mexico is not a GATT signatory, there is no requirement that an importing country find an injury to its industry before imposing countervailing duties.<sup>35</sup> Even if Mexico were conceded the benefit of an injury test prior to the imposition of countervailing duties, such concession would be contingent on a Mexican decision to phase out the incentives in question. Mexico would face a troublesome dilemma. It needs the export market as an outlet for its developing industry, but it needs the incentives to develop its industry along the lines of its various industrial growth plans. The United States and Mexico are currently negotiating a bilateral "substantially equivalent" agreement that would grant Mexico the injury test in exchange for restrictions on its subsidies.

### *B. National Energy Plan (NEP)*<sup>36</sup>

The Mexican Constitution reserves the ownership of subsurface minerals to the Mexican Government.<sup>37</sup> Although Article 27 of the Constitution of 1917 affirmed the national patrimony of subsurface minerals in Mexico, the exercise of rights over petroleum resources was acceded during the next two decades to foreign individuals and firms.<sup>38</sup> Not until the nationalization of foreign oil holdings in 1938 was the principle of national ownership irrevocably affirmed. As a consequence, Mexico

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<sup>32</sup> Countervailing Duty Concerns, *supra* note 1, at 8.

<sup>33</sup> M.I.D.P., *supra* note 18, at 24.

<sup>34</sup> *Id.* at 24-26.

<sup>35</sup> *Id.* at 238.

<sup>36</sup> *Id.* at 67-76.

<sup>37</sup> A. Gandora, R. Nehring & D. Ronfeldt, *Mexico's Petroleum and U.S. Policy: Implications for the 1980's* 42-46 (1980) (prepared for U.S. Department of Energy).

<sup>38</sup> *Id.*

keeps all energy dealings with foreign oil firms in the context of arm's-length transactions.

In its NEP introduced in November 1980, Mexico dedicated the use of its energy resources to the development of domestic industry, not to supplying foreign markets. Until recently Mexico has been unmoved by U.S. energy security needs, viewing U.S. dependence on Mexican oil as a threat to its own sovereignty.<sup>39</sup> Fearful of any foreign dependence on its oil, Mexico based its NEP on the dual principles of nationalism and conservation. It set clear and explicit limits on trade in energy resources. The plan stipulated that oil exports would not exceed 1.5 million barrels a day, not more than half of which would go to any one country.<sup>40</sup> Although Mexico thereby signaled to U.S. oil firms the limits of dependence on its oil, namely 750,000 barrels a day, economic conditions have forced a change in that policy. In light of Mexico's current financial crisis, it is increasing production to more than two million barrels per day with more than 50 percent going to the United States. The United States for its part made an advance payment of \$1 billion for Mexican oil for the U.S. Strategic Petroleum Reserve.<sup>41</sup>

Similarly, the plan limits natural gas exports to 300 million cubic feet per day.<sup>42</sup> López Portillo had made arrangements in 1977, at some political risk, to build a pipeline to the U.S. border to sell natural gas to the United States. Stung by the United States' rejection of the offer, López Portillo committed Mexico's gas resources to fueling Mexican industry instead.<sup>43</sup> Nonetheless, because of the recent weakening of oil prices, Mexico has begun to explore the possibility of doubling its sales of natural gas to the United States and discussions are once again under way with interested U.S. buyers.<sup>44</sup>

Whatever the prospects for increased fuel trade with Mexico, development of Mexico's own refining industry will generate demand for a large flow of equipment imports. For example, when PEMEX, Mexico's nationalized oil industry, purchased \$2 billion worth of refining equipment in 1979, more than half of it came from foreign suppliers, of which the United States supplied two-thirds.<sup>45</sup> PEMEX, which planned to continue building through 1986, estimated that imports of another \$8 billion worth of equipment, calculated at 1978 prices, would be needed.<sup>46</sup> PEMEX projections must be revised downward substantially and estimates of demand for imported equipment reduced accordingly in view of the current accounts crisis.

<sup>39</sup> *Id.* at 60.

<sup>40</sup> M.I.D.P., *supra* note 18, at 68.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 67.

<sup>44</sup> Mexico will not increase gas exports until 1983, *J. of Com.*, May 6, 1982, at 22B, col. 4.

<sup>45</sup> M.I.D.P., *supra* note 18, at 71.

<sup>46</sup> *Id.*

The pattern of energy trade with Mexico will evolve in subtle and complex ways especially in light of the erosion of Mexico's determination to limit such trade. Mexico's needs, not only for foreign exchange to finance its industrial independence, but also for technological development, have already lead Mexico to raise its energy trade level to acquire technology from potential trading partners. In fact, Mexico's offers to sell its oil to European countries as a bargaining chip to obtain technological know-how no longer command the premium they did when there was little talk of oil gluts. As U.S. energy prices are rising to world levels because of deregulation, the United States is actually retrenching on its consumption of imported fuels. In 1981, U.S. imports of oil dropped 11.7 percent.<sup>47</sup> The irony of U.S.-Mexico energy trade relations is that the less fuel the United States needs to import, the more it seems it can rely on Mexico for supplies.

*C. Sistema Alimentario Mexican (SAM)*<sup>48</sup>

A dramatic change in traditionally agricultural Mexico occurred in the past decade. Once a net exporter of agricultural products, Mexico now is a net importer.<sup>49</sup> The change was caused by a combination of several years of drought in the 1970s and policies designed to restrain food price increases for the expanding population.<sup>50</sup> These conditions aggravated productivity in the agricultural sector, and as a result agricultural land and resources were shifted from cultivation of domestic food supplies to the commercial production of beef, fruits, and vegetables for export. Dependence on agricultural imports increased as imports of corn, wheat, sorghum, and soya jumped from 3.4 and 3.6 million tons in 1978 and 1979 to 7.2 millions tons in 1980.<sup>51</sup>

Private commercial farmers, on the other hand, have been successful in growing fruit and vegetables for U.S. consumption during the winter months. For example, such farmers supply sixty percent of the U.S. winter market for tomatoes.<sup>52</sup> Production of winter vegetables provides a livelihood for an estimated 350,000 Mexican workers,<sup>53</sup> but it may be reaching the maximal feasible ceiling. Since Mexican tomatoes reach the U.S. markets well before U.S.-grown tomatoes, Mexican producers receive premium prices. Florida winter vegetable growers have often charged the Mexican growers with dumping their products in the U.S. markets. Although a recent U.S. Government investigation did not sub-

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<sup>47</sup> Bach, U.S. International Transactions, Fourth Quarter and Year 1981. Surv. Current Bus. 41 (March 1982). Bach points out that "for the year, the average number of barrels imported daily declined to 6.25 million from 7.08 million."

<sup>48</sup> M.I.D.P., supra note 18, at 31.

<sup>49</sup> Id. at 143.

<sup>50</sup> Id. at 32, 143.

<sup>51</sup> Id. at 32.

<sup>52</sup> Id. at 255. Exports to the United States of other winter vegetables are substantially less than exports of tomatoes. Id.

<sup>53</sup> Id. at 256.

stantiate the charges, the case is currently on appeal.<sup>54</sup>

However successful Mexico has been at producing for export, its real challenge lies in increasing food production for domestic consumption. Mexico's population of seventy million grows annually by 2.9 percent, and therefore, considering Mexico's gradually increasing per capita income, the demand for basic food stuffs should increase by two to eight percent.<sup>55</sup> To meet this challenge, López Portillo introduced SAM in the spring of 1980.<sup>56</sup>

SAM sets forth incentives to develop the less productive agricultural sectors in the marginally rain-fed regions. It aims to make Mexico self-sufficient in corn and beans by 1982 and to meet the minimally sound nutrition requirements for the poor rural sectors. SAM's incentives include preferential credits, subsidies on seeds, fertilizers, pesticides, and crop insurance for corn and bean crops. These incentives, like those incorporated in the NIDP, are subject to the challenge that they are subsidies and thus may be vulnerable to the imposition of countervailing duties. Despite these incentives, the 1982 severe drought is likely to oblige Mexico once again to import huge amounts of foodstuffs.

#### *D. National Plan for Agro-Industrial Development (NPAD)*<sup>57</sup>

The NPAD, also released in early 1980, sets the goals and parameters for Mexico's agribusiness development. It is intended to guide the actions of the public sector and provide incentives to the social and private sectors. It supplements SAM in that it seeks to effect institutional changes in Mexico's agribusiness sector.<sup>58</sup> Some of the NPAD mechanisms, like those used in NIDP and SAM, may encounter challenges from producers that sell in markets to which Mexico exports. Fiscal incentives, public investment, subsidies, and restrictions on foreign investment and business are practices that will be carefully scrutinized by those competing with Mexican imports.

### III. Canadian Trade Policies

The Canadian Government clearly exerts a positive force on Canadian business development. This is demonstrated by its efforts to establish a national energy firm, Petro-Canada,<sup>59</sup> to "Canadianize" industries,<sup>60</sup> and to review foreign investment according to the contribu-

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<sup>54</sup> Trade Agreements, *supra* note 10, at 39, 41.

<sup>55</sup> M.I.D.P., *supra* note 18, at 167.

<sup>56</sup> *Id.* at 33.

<sup>57</sup> *Id.* at 169-75.

<sup>58</sup> *Id.* at 170-71.

<sup>59</sup> P. Morici, A. Smith & S. Lea, Canadian Industrial Policy 118 (1981) [hereinafter cited as Canadian Industrial Policy]. See also W. Armstrong, L. Armstrong & F. Wilcox, Canada and the United States: Dependence and Divergence 80 *passim* (1982) [hereinafter cited as Canada and the United States].

<sup>60</sup> Canada and the United States, *supra* note 59, at 164.

tion it can make to Canada.<sup>61</sup> To the extent that Canada's development policies have trade-distorting effects, the United States is obliged to counter them, because Canada is the largest trading partner of the United States.

Perhaps the tensions generated by this partnership are inevitable; the two economies constantly interact across the 3,500-mile border shared by the two independent nations. Canada's land mass stretches northward nearly three thousand miles across the tundra to the Arctic, but living space for the majority of its population is limited to the narrow band of territory within two hundred miles of the U.S. border.<sup>62</sup> The need for efficiency dictates that firms from both countries reach across their national border. Few plants could exhaust their economies of scale by producing goods to supply a market area with a radius of only a hundred miles. Few plants could minimize their transportation costs by serving an attenuated market area measuring two hundred by three thousand miles. Similarly, advertisers ignore the border as they broadcast their messages into each other's country to promote their products and services in as large a market area as they are distributed.

Fostering the development and "Canadianization" of industry inevitably has involved the adoption of practices that restrict trade and foreign investment and that grant subsidies or other preferences to domestic firms. This trend has come to the fore dramatically in programs and legislation initiated by Canada in the past decade. The result is unbalanced accessibility to the markets of the two countries.

#### *A. Foreign Investment Review Agency (FIRA)*<sup>63</sup>

Canadians have long been critical<sup>64</sup> of the "branch plant" strategy, which they have attributed to foreign firms that invest in Canada. By this strategy, foreign firms tend to establish their plants to supply the surrounding Canadian market and escape the relatively higher tariffs. Canadians have argued that these plants tend to be less integrated into total company operations, to expend less on research and development, and to be the first plants closed by the home office when slackening demand forces cutbacks in productions.<sup>65</sup> To counter these inefficiencies of the "branch plant" syndrome, Canada instituted the policy of "Canadianizing" the local industry and, in 1973, established FIRA to carry out this policy. FIRA's objectives were to increase Canadian control over

<sup>61</sup> Canadian Industrial Policy, *supra* note 59, at 85-86; Canada and the United States, *supra* note 59, at 82, 165.

<sup>62</sup> S. Birnbaum, *Canada* 1980 3 (1979).

<sup>63</sup> Canadian Industrial Policy, *supra* note 59, at 85 *passim*. See also Canada and the United States, *supra* note 59, at 118.

<sup>64</sup> Canada and the United States, *supra* note 59, at 120.

<sup>65</sup> Canadian Industrial Policy, *supra* note 59, at 86-87. Morici lists ten criteria for FIRA acceptance of foreign investment proposals and includes such things as additional employment, investment, productivity, innovation, technology, and exports.

foreign investment in Canada and to ensure that Canada benefits from such investment. Firms intent on entering Canada are screened carefully for their expected contribution to Canadian development, but no reports on the FIRA reviews are issued. In addition to the lack of public information on the FIRA administrative procedures, successful U.S. firms often refuse to disclose the terms on which they agreed to secure permission for their proposed investment.

FIRA has the authority to impose performance requirements that affect both imports and exports as conditions of entry into Canada.<sup>66</sup> The requirements may stipulate that a specific percent of a firm's final product be composed of locally supplied material, or that the firm commit itself to export a specified percentage of its output to earn foreign exchange for the Canadian host government.

FIRA also may assert an extraterritorial veto power over the transfer of Canadian assets overseas,<sup>67</sup> for example, from one U.S. owner to another. Practices of this nature pose serious policy questions for U.S. firms but even more so for the U.S. Government. Although these practices give Canada more control over its industry, they constitute direct interference with the free flow of trade and investment transactions overseas.

In recent years, some Canadians have proposed<sup>68</sup> that FIRA extend its screening practices to foreign investments that existed prior to the 1973 FIRA enactment. Canada's retroactive extension of the screening investment practice might have discriminatory and possibly expropriatory implications. A retroactive application of the FIRA provisions may be contrary to the letter and spirit of international obligations, such as those outlined in the 1976 OECD agreement on national treatment for foreign firms,<sup>69</sup> and could nullify some of the benefits of previous trade concessions. In the April 1980 "speech from the throne," the Canadian Government announced its intention to expand FIRA's scope beyond new investment screening to include performance reviews of existing investments, especially in technologically advanced industries.<sup>70</sup> This provoked a vigorous protest from the United States.<sup>71</sup> Subsequently, in its budget presentation in November 1981, the Canadian Government committed itself to refrain from expanding FIRA's mandate for the time being and to complete an administrative review of

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<sup>66</sup> Canada and the United States, *supra* note 59, at 121.

<sup>67</sup> *Id.* at 124. An instance of this occurred when the U.S. firm, Dow Jones, acquired another U.S. firm, Richard D. Irwin, Inc., that had a wholly owned Canadian subsidiary. A Canadian court held that the acquisition was subject to FIRA review.

<sup>68</sup> Drouin & Malmgren, Canada, the United States and the World Economy, *Foreign Aff. Winter* 1981-82, at 402-403 [hereinafter cited as Canada, the U.S. and the World Economy].

<sup>69</sup> International Investment and Multinational Enterprises (Paris: OECD, 1979 ed.), 11-13, reprinted in Canada and the United States, *supra* note 59, at 109.

<sup>70</sup> Canada and the United States, *supra* note 59, at 122.

<sup>71</sup> Canada, the U.S. and the World Economy, *supra* note 68, at 402-403.

FIRA.<sup>72</sup> An extensive cabinet shuffle in September 1982, in which the forceful head of FIRA was replaced by the former Minister of State, is widely regarded as a signal of Canada's easing of its implementation of nationalist economic programs, such as FIRA and NEP.

*B. National Energy Plan (NEP)*<sup>73</sup>

More recently, the Canadian Government has sharply focused the "Canadianization" process on its energy sector. Announced in 1980, the NEP is designed to increase Canadian ownership and control of the country's energy sector. In some ways, it seeks to reacquire the energy concessions made in the past to foreign firms. The implementing legislation, introduced in the Canadian Parliament in 1981,<sup>74</sup> has provisions that some Americans view as discriminatory and expropriatory<sup>75</sup> and significantly departs from internationally accepted principles of fair and equitable treatment of foreign investments.

The motives behind the legislation are complex. They concern not only "Canadianization" of the industry but also development of a federal energy base to counterbalance the current energy-rich provinces.<sup>76</sup> While Petro-Canada, a federal energy entity, ultimately will emerge strengthened as a result of the NEP, the foreign subsidiaries of energy firms will be adversely affected by the discrimination. Canada's justification for the "Canadianization" of the energy industry rests on the government's perceived need<sup>77</sup> to reduce foreign ownership from the prevailing seventy percent level.

One provision of the NEP arrogates to the Canadian Government a twenty-five percent share of all leases on Canadian federal lands.<sup>78</sup> In return for this twenty-five percent share of oil and gas production revenues, the Canadian Government will compensate firms for twenty-five percent of their exploration and drilling costs incurred in developing productive wells. The costs incurred for nonproducing wells are not reimbursable.

With control over Petro-Canada, a substantial energy supplier, the government will be in a better position to pursue its proposed policy of supplying energy to Canadian industry at eighty-five percent of world prices. Reportedly, these prospects are regarded grimly by energy firms in Canada, who fear uncertainty and instability as much as constraints

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<sup>72</sup> Id.

<sup>73</sup> Canadian Industrial Policy, *supra* note 59, at 92; Canada and the United States, *supra* note 59, at 86.

<sup>74</sup> Canada, the U.S. and the World Economy, *supra* note 70, at 402.

<sup>75</sup> The legislation appears designed to ensure that only Canadian firms benefit from NEP and similar programs. This necessarily involves a denial of equal opportunity to foreign firms and their subsidiaries. *Id.* See also Canada Pays a Price for its New Nationalism, *Bus. Wk.*, August 17, 1981, at 42.

<sup>76</sup> Canada and the United States, *supra* note 59, at 40-41.

<sup>77</sup> *Id.* at 86-87.

<sup>78</sup> *Id.* at 87; Canada, the U.S. and the World Economy, *supra* note 71, at 401.

on their profitability.<sup>79</sup> U.S. firms, especially those using petrofuel as feedstock, also are concerned about the competitive edge the lower priced feedstocks will give its Canadian counterparts now that U.S. natural gas feedstock prices are being deregulated.<sup>80</sup>

Despite the projected benefits of the NEP, its overall effect, especially during the prolonged economic downturn, has not been beneficial to Canadian energy firms. They have endured losses or low levels of profits, whereas their multinational counterparts in Canada have reaped substantial profits.<sup>81</sup>

### *C. Border Broadcasting*

Apart from the energy and foreign investment policy thrusts described above, many individual areas of trade across open borders can be distorted by government administrative practices. One such practice was designed to benefit the Canadian domestic broadcast industry. Canada decided in 1976 that the estimated \$15 million in advertising costs expended by Canadian firms for broadcast time on U.S. radio stations were not acceptable tax deductions.<sup>82</sup> Because this practice threatened to cut their revenues, U.S. broadcast firms appealed to the U.S. Trade Representative for redress.<sup>83</sup> In the same year, a U.S. tax law was enacted disallowing taxpayer deductions for the costs of attending more than two conventions each year outside the United States.<sup>84</sup> Canada, standing to lose \$100 million in revenues, objected.<sup>85</sup> U.S. broadcasters quickly seized on the retaliatory linkage of the convention tax deduction with the Canadian tax deduction ban on U.S. broadcasting advertisements.<sup>86</sup> U.S. revisions of tax laws, however, undid the linkage,<sup>87</sup> and when President Jimmy Carter presented separate legislation countering the Canadian restriction on U.S. broadcast cost deductions to Congress, it was not passed.<sup>88</sup> A subsequent initiative by President Ronald Reagan has been submitted to Congress. These events illustrate how difficult it is to define and impose appropriate retaliation, especially cross-product retaliation. Often an industry is reluctant to accept, at some cost to itself,

<sup>79</sup> Canada and the United States, *supra* note 59, at 89.

<sup>80</sup> See Canadian Industrial Policy, *supra* note 59, at 98.

<sup>81</sup> The Canadian Economy is in Crisis, *Bus. Wk.*, June 28, 1982, at 80-87.

<sup>82</sup> Westell, *Poison Pinpricks*, *Foreign Pol'y*, Winter 1980-81, at 101.

<sup>83</sup> Trade Agreements Report, *supra* note 22, at 83. The complaint that the Canadian advertising tax education policy was an unfair trade practice under § 301 of the Trade Agreements Act of 1974, Pub. L. No. 93-618, 88 Stat. 1978, 2041-42 (1975), as amended by Trade Agreements Act of 1979, Pub. L. No. 96-33, 93 Stat. 44, 295-96 (codified at 19 U.S.C. § 2411 (Supp. IV 1980)).

<sup>84</sup> Westell, *supra* note 82, at 101. See Tax Reform Act of 1976, Pub. L. No. 94-455, § 602, 90 Stat. 1573 (repealed 1980).

<sup>85</sup> Westell, *supra* note 82, at 101.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.* See Act of Dec. 28, 1980, Pub. L. No. 96-608, § 4, 94 Stat. 3550, 3552-53 (codified at 26 U.S.C. § 274(h) (West Supp. 1982)).

<sup>88</sup> Westell, *supra* note 82, at 101.



trade restrictions that are designed as a mode of retaliation to benefit another sector.

#### *D. Canadian Bank Act*<sup>89</sup>

Canada enacted the Bank Act on December 1, 1980; it remains in effect until 1991. The Act enables foreign banks to enter Canada as chartered banks, although its provisions are carried out independently of FIRA.<sup>90</sup> Like FIRA, however, the Act sets conditions for entry, namely that the entrant be judged admissible according to the potential contribution it can make to competitive banking in Canada.<sup>91</sup> Furthermore, foreign banks will find that their admission will depend on the degree of reciprocity their home jurisdiction affords to Canadian banks.<sup>92</sup> While existing foreign banks with branch networks are allowed to continue under a grandfather clause,<sup>93</sup> new foreign bank entrants will be granted one main and one branch office with additional branches at the discretion of the Canadian minister.<sup>94</sup> Licenses will be subject to renewal annually for the first five years and reviewed triennially thereafter.<sup>95</sup> Another constraint is that assets of foreign bank subsidiaries be limited to eight percent of the total assets of Canadian domestic banks.<sup>96</sup>

While all countries subject their banking industry to regulations, Canada's restraints limit not only the entry of banks but also the growth potential of the foreign banks within the Canadian banking sector. However, U.S. imposition of reciprocal sanctions against Canada's banking laws, should it ever be needed, would be complicated, because of the large number of state regulatory jurisdictions involved.

#### *E. Government Procurement*

Government procurement to foster Canadian development is a type of intervention policy that might be anticipated as a preferred practice. Recently, the procedure for this practice has been formalized with the establishment of a Procurement Review Mechanism, according to which the Treasury Board ensures that government purchases for goods and services over \$2 million and construction over \$10 million meet government objectives.<sup>97</sup>

On December 30, 1981, Canada became a signatory to the GATT Procurement Code.<sup>98</sup> While discriminatory procurement practices must

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<sup>89</sup> Trade Agreements, *supra* note 10, at 32.

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> Canadian Industrial Policy, *supra* note 59, at 122.

<sup>98</sup> General Agreement on Tariffs and Trade, Multilateral Trade Negotiations: Status and

be eschewed, according to the terms of the Code,<sup>99</sup> significant areas of purchasing by federal, provincial, and local government, as well as by Crown Corporations, are not covered by the Code. The Canadians, for their part, object to individual state "Buy American" laws<sup>100</sup> and especially to the federal constraints imposed by the U.S. Surface Transportation Act<sup>101</sup> which affect purchases of transportation equipment, an area in which Canada possesses a comparative advantage.

#### IV. Sectoral Trade Arrangements

The divergent policies of the United States, Canada, and Mexico toward industrial development, trade, and investment suggest that much groundwork must be accomplished before a regional multilateral trade agreement is feasible. The appeal of such an agreement appears limited at this time, notwithstanding the vast complementary assets that form a basis for the extensive intraregional trade existing today, because the enormous interdependence that such trade flows represent has evolved not through government agreements but largely through private sector initiatives.

Nonetheless, Canada and Mexico realize the importance of an open U.S. market, a market that accounts for two-thirds of their total world trade.<sup>102</sup> At the same time they are conscious of their sovereign responsibility to adopt industrial policies to benefit their citizenry. Tension arises when this conflicts with the responsibility of remaining an equitable trading partner in a liberal trading system.

Whatever the prospects for an overall trade agreement among North American countries, some concrete steps have been taken by the governments of these countries to deal constructively with trade opportunities. There is solid economic justification for the arrangements in some cases, as in the Auto Products Trade Agreement of 1965 (APTA)<sup>103</sup> and the cross-border electricity sharing arrangements,<sup>104</sup> where U.S. summer peak demand for air conditioning complements with compelling economy Canada's peak winter usage of electricity for heating and lighting.

Other arrangements have important concessionary aspects, such as the Generalized System of Preferences (GSP)<sup>105</sup> and the Border Industry

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Acceptances of Protocols, Agreements, and Arrangements, at 5, U.N. Doc. L/4914/Rev.5 (1981).

<sup>99</sup> House Comm. on Ways and Means, Senate Comm. on Finance, 96th Cong., 1st Sess., Multilateral Trade Negotiations, International Codes Agreed to in Geneva, Switzerland April 12, 1979, Agreement on Government Procurement, Part II, 1. (Comm. Print 1979).

<sup>100</sup> Canada and the United States, *supra* note 59, at 172.

<sup>101</sup> *Id.* at 172-73.

<sup>102</sup> Background Study, *supra* note 4, at 248-49, 270-71.

<sup>103</sup> Canada and the United States, *supra* note 59, at 132-36; Canada Industrial Policy, *supra* note 59, at A-8; Background Study, *supra* note 4, at 116-18.

<sup>104</sup> Canada and the United States, *supra* note 59, at 95-96.

<sup>105</sup> M.I.D.P., *supra* note 18, at 256. See generally Office of the U.S. Trade Representative, A Guide to the U.S. Generalized System of Preferences (1981).

Program (BIP).<sup>106</sup> The GSP authorization is scheduled to expire January 4, 1985. These programs create an estimated 260,000 jobs and 131,000 jobs, respectively.<sup>107</sup> Winter vegetables marketed in the United States in the face of considerable opposition from domestic growers generate incomes for another 350,000 Mexicans.<sup>108</sup> While continuance of such programs may be contingent upon Canada's and Mexico's maintenance of acceptably equitable trade relationships with the United States, the BIP in Mexico and the APTA with Canada are illustrative of arrangements that, with adaptations, may be suitable for application to other potential trade expanding arrangements.

#### *A. Mexican Border Industries*

After the discontinuance of the "bracero" farm worker program in 1964,<sup>109</sup> the United States participated in setting up a border program in 1965. To encourage industrial development in Mexico along the U.S. border, a tariff concession was extended to in-bond plants, or *maquiladoras*, in Mexico.<sup>110</sup> This concession allows the Mexican plants to import U.S. products, holding them in bonded plants for further processing, and then to re-export them in finished products while paying U.S. duty only on the value added by the processing in Mexico. The plants that qualify for these concessions are those designated as producing goods listed under Sections 806.30 and 807 of the U.S. Tariff Schedule.<sup>111</sup>

Mexican legislation has further enhanced the incentives for locating along the border. In 1971 Mexico established a Public-Private Development Commission<sup>112</sup> to oversee regional policies, and in 1972 laws were modified to grant concessions related to taxes, customs, and transportation.<sup>113</sup> In addition to duty exemption on inputs for these in-bond industries, other special concessions include a ten-year holiday on value-added taxes,<sup>114</sup> duty exonerations on capital goods imported for local industries,<sup>115</sup> and discounts on rail and maritime rates.<sup>116</sup>

The border program has succeeded because of the cooperation between the two countries. In the decade of the 1970s, exports under the plan increased tenfold, plants multiplied fivefold (rising from 120 to 600 establishments), and employment reached 131,000 employees, mostly un-

<sup>106</sup> M.I.D.P., *supra* note 18, at 28-29, 255. See also Background Study, *supra* note 4, at 65-66.

<sup>107</sup> M.I.D.P., *supra* note 18, at 255-56.

<sup>108</sup> *Id.* at 256.

<sup>109</sup> RedClift & RedClift, *Unholy Alliance*, *Foreign Pol'y*, Winter 1980-81, at 120, 122-23.

<sup>110</sup> See M.I.D.P., *supra* note 18, at 29, 255.

<sup>111</sup> Background Study, *supra* note 4, at 65-66.

<sup>112</sup> M.I.D.P., *supra* note 18, at 29.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

skilled women.<sup>117</sup> This success is consistent with both the original aim of the *maquiladora* program and the subsequent goals of the Urban Development Plan.<sup>118</sup> The latter calls for the diffusion of Mexico's population outside of the overcrowded Federal District where fourteen million of the country's people now live.<sup>119</sup> The program also is consistent with U.S. objectives of simultaneously fostering employment and fighting inflation, because U.S.-made components accounted for one-half of the value of the final products.<sup>120</sup> In short, the program appears to wed the comparative advantages of both countries. The recent devaluation of the Mexican peso has made these plants more attractive by cutting labor costs in dollars dramatically, putting them in the range of similar labor costs in Taiwan, Hong Kong, and South Korea.<sup>121</sup>

Some individuals have proposed a creative extension of this program by suggesting a free trade zone along the Mexican-U.S. border as an initial phase of a complete liberalization of trade in North America. Ambassador Abelardo Valdez, formerly with the U.S. State Department, has been a strong advocate of this approach, calling for a free trade band of 100 or 200 miles on both the Mexican and U.S. sides of the border.<sup>122</sup> Goods produced within the zone would move duty free. While there are serious administrative barriers to its effective implementation, the concept is provocative and may stimulate the search for additional, creative solutions.

#### *B. Automotive Products Trade Agreement of 1965 (APTA)*<sup>123</sup>

The United States and Canada signed the APTA in 1965 to introduce limited free trade in new automotive vehicles and components. The 1936 domestic content requirement<sup>124</sup> had granted duty-free status to auto components imported by auto makers in Canada whose production was at least sixty percent Canadian in origin. This policy no longer served Canadian domestic production objectives. Canada's apprehension at the decline of its domestic auto production from 110 percent of apparent consumption in the 1950s to 72 percent in the early 1960s<sup>125</sup> led it to enact in November 1962 a policy of remitting the 25 percent tariff on auto parts whenever auto makers increased their exports over and above the amount of exports in the prior base period.<sup>126</sup> The incentive worked. The Canadian content of Canada's automotive exports

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<sup>117</sup> *Id.* at 255.

<sup>118</sup> *Id.* at 20.

<sup>119</sup> *Id.*

<sup>120</sup> Background Study, *supra* note 4, at 161.

<sup>121</sup> Hayes, *Peso Cut Aids Plants at Border*, N.Y. Times, Sept. 20, 1982, at D1, col. 4.

<sup>122</sup> J. of Com., Nov. 28, 1980, at 10, col. 3.

<sup>123</sup> Canadian Industrial Policy, *supra* note 59, at A-2 to A-8. Canada and the United States, *supra* note 59, at 132-36.

<sup>124</sup> *Id.* at A-2.

<sup>125</sup> *Id.* at A-3.

<sup>126</sup> *Id.* at A-4.

jumped from \$9.5 million in 1962 to \$65.3 million in 1964.<sup>127</sup> However, U.S. producers of automotive components reacted strongly. A U.S. radiator manufacturer petitioned the Treasury Department to begin a countervailing duty investigation on the grounds that the duty remission was an export subsidy.<sup>128</sup> The potential for trade confrontation was high, and a bold plan for an automotive agreement emerged as a viable alternative.

In essence, APTA created the basis for an integrated U.S.-Canadian automotive industry and market. It achieved this by promoting trade in new automotive vehicles and parts on a duty-free basis. To preserve the size of its industry, Canada stipulated that the dollar volumes of imports and exports of automotive products are to be maintained at levels above those that prevailed prior to the agreement.<sup>129</sup>

Both countries have adopted measures to prevent huge transshipments from other countries for marketing under the pact. To satisfy the U.S. requirement, vehicles must have at least fifty percent North American content to enter under the agreement.<sup>130</sup> Canada restricts auto imports under the agreement to bona fide manufacturers and then only if they maintain specified made-in-Canada to sales-in-Canada proportions and meet Canadian value-added standards.<sup>131</sup>

The arrangement has helped the auto industry in both countries to rationalize production. One measure of the integration achieved is the sharp increase in automotive trade flows, from \$716 million in 1964 to over \$20 billion in 1980.<sup>132</sup> An index of the agreement's effectiveness is that Canada, which has generally been a high-cost producer of goods, now manufactures automotive products at costs that are within three percent of those in the United States. The ultimate testimony to APTA's success, though, is its durability; it has been in force for seventeen years, and the only proposals for changing it are extensions to cover tires, aftermarket parts, and special purpose vehicles.

The question arises whether APTA is sufficiently successful to be proposed as a model for replication in other sectors or in other countries. There are genuine limitations to its wider application. For one thing, the oligopoly structure of the auto industry is not typical of most manufacturing sectors. There are four major motor vehicle producers in Canada all of which are wholly-owned subsidiaries of U.S. vehicle manufacturers.<sup>133</sup> This restricted ownership facilitated achieving a consensus prior to the agreement and monitoring conformance to it afterward.

In addition, despite the relative homogeneity of the industry and the

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<sup>127</sup> *Id.* at A-5.

<sup>128</sup> *Id.* at A-6.

<sup>129</sup> *Id.* at A-7.

<sup>130</sup> Trade Agreements, *supra* note 10, at 54.

<sup>131</sup> *Id.*

<sup>132</sup> *Id.* at 53.

<sup>133</sup> Background Study, *supra* note 4, at 116.

host countries, problems could yet arise from the different perceptions of the nature of the agreement. Canada perceives it as a fair share arrangement,<sup>134</sup> whereas the United States views it as a limited free trade agreement.<sup>135</sup> Market sharing arrangements are conceptually alien to U.S. public policy, which is based on the normative model of pure competition.

In the context of North American trade agreements, some suggest that APTA be extended to include Mexico. Such an extension may evolve, but not before a greater harmonization of the automotive sectors in the three countries is accomplished. Of the eight "terminal" auto makers in Mexico, so called because they have survived the stringent regulations of the 1962 Automotive Decree,<sup>136</sup> four are U.S. firms. Their plants are relatively small and have high operational costs,<sup>137</sup> although some new automotive investments are of greater magnitude to capture economies of scale in production and to provide a source of components for plants producing "world cars."

The Mexican Automotive Decree of 1977<sup>138</sup> fosters the adoption of import substitution and export promotion strategies through the use of local ownership incentives, local content requirements, and rebates on taxes and import duties.<sup>139</sup> In time, these measures are likely to cause U.S. subsidiaries in Mexico to increase their production for export to the United States. Then when they capture a significant share of the U.S. market for autos and auto parts, they may seek to enlarge the existing automotive accord with Canada to include the Mexican industry.

Although there are problems with APTA, its success suggests that consideration be given to exploring the benefits of introducing sectoral agreements in other industries. Like the genesis of the U.S.-Canadian auto agreement, sectoral agreements could begin as bilateral accords. Separate U.S. agreements with both Canada and Mexico might provide an interim harmony, after which trilateral application could be pursued. Sectors in which all three countries are variously endowed and in which trade potential is high include petrochemicals, forest products, transportation, and the energy sources of coal, electricity, natural gas, and oil. While the mention of energy triggers apprehensions about U.S. intentions, several other sectors already are being examined jointly by the new consultative mechanism, the Joint Committee on Commerce and Trade (JCCT).

### *C. Consultative Mechanisms*

When Presidents Ronald Reagan and José López Portillo met in

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<sup>134</sup> Trade Agreements, *supra* note 10, at 53.

<sup>135</sup> *Id.*

<sup>136</sup> M.I.D.P., *supra* note 18, at 90.

<sup>137</sup> *Id.* at 91.

<sup>138</sup> *Id.* at 98 *passim*.

<sup>139</sup> *Id.*

June 1981, they established a new Joint Committee on Commerce and Trade (JCCT).<sup>140</sup> At the first JCCT meeting on September 21 and 22, 1981 in Mexico City, the participants acknowledged the need for a more reliable system of prior notification and consultation about changes in trade policies. Among the specific issues discussed were U.S. countervailing duty laws, Mexico's development incentives program, U.S. sales of silver from its strategic stockpile, the increase in Mexican tariffs and import licensing requirements, U.S. policies on graduation within the Generalized System of Preferences, and the difficulties encountered by U.S. trucking and engineering firms doing business in Mexico. To address these issues constructively and systematically, the JCCT developed a work program that includes a comprehensive examination of the automotive, petrochemical, computer, and textile sectors. Under the aegis of the JCCT, the United States and Mexico are looking into an automotive agreement similar to the U.S.-Canada pact. Mexico's computer plans are being studied by the JCCT for a similar joint development effort.

So far the JCCT appears to be more effective than the Consultative Mechanism established in 1976 and displaced by the JCCT. In addition to the JCCT, the United States has over a hundred agreements with Mexico. One of the oldest, the International Boundary and Water Commission,<sup>141</sup> founded in 1889, continues to generate distinctive success in fairly complex cases that ultimately are critical to fostering a sense of community. However, as long as the meetings of commissions and the terms of agreements are carried out without a framework that delineates the long-term objectives shared by North American countries, the efforts of all these meetings and agreements may be at cross-purposes in the long run.

Canada and the United States do not have as effective a counterpart to the U.S.-Mexican JCCT. The Joint Canada-U.S. Committee on Trade and Economic Affairs,<sup>142</sup> operating at the cabinet level, acts as a general policy-making committee. In the past, it has concerned itself with U.S.-Canada balance-of-payments issues, but its meetings in the 1970s were infrequent, and its importance has diminished.

A number of U.S.-Canadian treaties are important in handling U.S. relations in areas of specific and critical cooperation. For example, the Defense Production Sharing Agreement<sup>143</sup> directs apportionment of production costs of material used in common defense efforts. A separate board, the Permanent Joint Board of Defense,<sup>144</sup> serves a consultative and advisory function to mesh complex, shared military requirements

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<sup>140</sup> Canada, the U.S. and the World Economy, *supra* note 68, at 412.

<sup>141</sup> F. Huszagh, Comparative Facts on Canada, Mexico, and the United States, 145-46 (1979) [hereinafter cited as Comparative Facts].

<sup>142</sup> *Id.* at 50.

<sup>143</sup> D. Murray, An Evaluation of U.S.-Canadian Defense Economic Relationship and its Applicability to NATO Standardization (1978).

<sup>144</sup> Comparative Facts, *supra* note 141, at 53.

with political and economic exigencies. Other agreements include Science and Technical Cooperation,<sup>145</sup> Resources Development, Conservation, and Environmental Management,<sup>146</sup> Trade and Energy,<sup>147</sup> Balance of Payments Committee,<sup>148</sup> Energy Consultative Mechanism,<sup>149</sup> Anti-trust Consultative Mechanism,<sup>150</sup> and the International Joint Commission.<sup>151</sup> This last arrangement, like its Mexican counterpart, the International Boundary and Water Commission,<sup>152</sup> is relatively long-standing, founded in 1909, and is regarded as successful in its endeavors.

#### *D. Communications at the State Level*

At the state level, a large number of informal working relations have developed. These have been classified as on-going agreements, understandings, or arrangements. Some 766 of these relationships between the U.S. individual States and the Canadian Provinces have been identified.<sup>153</sup> With Mexico, the relations between the bordering states tend to be formalized as U.S. State Commissions. The Good Neighbor Commission of Texas,<sup>154</sup> founded in 1943, is the oldest. Commissions relating to Mexico were set up in Arizona<sup>155</sup> in 1959, in California<sup>156</sup> in 1964, and in New Mexico<sup>157</sup> recently. Also, the Annual Southwest Border Governors Conference has had an active influence over the years.

### **V. Framework for a New Relationship**

Despite the significant integration of North American markets achieved through trade and investment, and despite the numerous communications between government groups at all levels, there remains, what the Canadian statesman, Maxwell Cohen, described as "a general poverty in the institutional network that links" the three countries.<sup>158</sup> Likewise, there is a conspicuous absence of a mutually accepted perception of the relationships among the North American countries. The old "special" relationships between the United States and each of its neighbors no longer provides policy guidance and support to bilateral consultations. Institutional trade cooperation is especially difficult now,

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<sup>145</sup> *Id.* at 47.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.* at 48.

<sup>148</sup> *Id.* at 51.

<sup>149</sup> *Id.* at 52.

<sup>150</sup> *Id.* at 53.

<sup>151</sup> *Id.* at 51.

<sup>152</sup> *Id.* at 145.

<sup>153</sup> 1 Canadian Senate Standing Committee on Foreign Affairs, Canada-United States Relations 31 (1975) (noting R. Swanson, State Province Interaction 41 (Aug. 1974) (prepared for U.S. Department of State)).

<sup>154</sup> Comparative Facts, *supra* note 141, at 141.

<sup>155</sup> *Id.* at 147-48.

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> Westell, *supra* note 102, at 110.



because the national development policies of Canada and Mexico sharply diverge from those of the United States.

Yet the divergencies from trade liberalization responsibilities cannot be ignored. The current world recessionary forces tend to magnify the negative impact on the U.S. economy of trade and investment distortions. Furthermore, continued U.S. indulgence may be misconstrued by our trading partners as legitimating acceptance of their trade restrictive measures.

A search for an overall resolution of trade issues, however, is hindered by the lack of mutually acceptable trade perspectives. If a unifying perspective is to evolve and capture an effective constituency in all three countries, it must be rooted in a shared vision. That vision must project an ideal that appeals to a broad range of people in each country, convey a sense of the mutual benefits promised, and suggest an implementing mechanism that assures an equitable outcome for all participants.

Sometimes such a vision evolves naturally. More often it is forged by innovative leaders in the face of widely acknowledged exigencies. With varying degrees of effectiveness and permanence, Franklin D. Roosevelt cultivated the Pan American Good Neighbor policy, John F. Kennedy summoned up the Alliance for Progress, and Ronald Reagan seeks to launch a Caribbean Basin Initiative.

How can the emergence of a vision of greater North American unity be deduced from the existing mix of cooperative efforts, conflicting policies, and expanding trade and investment patterns that characterize North American economic relations? The Brandt Commission faced a similar, though greater, challenge when it was established "to study the grave global issues arising from the economic and social disparities of the world community and to suggest ways of promoting adequate solutions to the problems involved in development and in attacking absolute poverty."<sup>159</sup> It is possible that a commission could be set up to accomplish for the concept of a North American trade relationship what the Brandt Commission attempted to do for the North/South concept. The dialogue of a dozen or so eminently knowledgeable persons selected for their preeminence in the business sector, public life, and academic communities of all three countries might crystallize a conceptual framework for a viable North American trade arrangement. The report of such a commission should be exploratory and should inform all North Americans of choices in trade relations that lie ahead and the costs and benefits of each. Their insights might stimulate a conscious convergence of North American markets through better coordination of their trade, investment, and industrial trade policies.

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<sup>159</sup> W. Brandt, *North-South: A Programme for Survival* 296 (1980).